



## **Digitization of Income Tax Administration in India**

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### **ABSTRACT**

*Several initiatives have been launched by the Income Tax Department in recent years to promote the use of information technology (IT) and IT-enabled services for the efficient and transparent administration of income tax. This paper outlines the importance of the digital economy and knowledge economy in the context of tax administration in India. It outlines the various initiatives taken by the government of India that have simplified tax compliance and eased the compliance burden.*

**Keywords:** *Tax administration; Digital economy; Knowledge economy; Income tax.*

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### **1.0 Introduction**

In continuation with the government's emphasis on providing a more transparent, efficient and tax-payer friendly tax administration and improving taxpayer convenience, several initiatives have been launched by the Income Tax Department in recent years to promote the use of information technology (IT) and IT-enabled services for efficient and transparent administration of income tax.

Most of the processes and compliance requirements have been shifted to online platforms and the need for the taxpayers to physically visit the income tax office has been eliminated or minimized. Interaction with taxpayers is characterized by a spirit of trust and respect, relying more on voluntary compliance.

### **1.1 Economics of digitization**

The economics of digitization is the field of economics that studies how digitization affects markets and how digital data can be used to study economics. Digitization is the process by which technology lowers the costs of storing, sharing, and

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analyzing data. This process has changed how consumers behave, how industrial activity is organized, and how governments operate. The economics of digitization exists as a distinct field of economics for two reasons. First, new economic models are needed because many traditional assumptions about information no longer hold in a digitized world. Second, the new types of data generated by digitization require new methods to analyze.

Research in the economics of digitization touches on several fields of economics including industrial organization, labour economics, and intellectual property. Consequently, many of the contributions to the economics of digitization have also found an intellectual home in these fields. An underlying theme in much of the work in the field is that existing government regulation of copyright, security, and anti-trust is inappropriate in the modern world. For example, information goods, such as news articles and movies, now have zero marginal cost of production and sharing. This has made the piracy of information goods common and has increased competition between providers of information goods. Research in the economics of digitization studies how policy should adapt in response to these changes.

A key issue in the economics of digitization is how much people value internet-based services. The motivation for this question is two-fold. First, economists are interested in understanding digitization related policies such as network infrastructure investment and subsidies for internet access. Second, economists want to measure the gains to consumers from the internet. This is an especially important topic because many economists believe that traditional measures of economic growth, such as GDP, understate the true benefits of improving technology.

Digitization has coincided with the increased prominence of platforms and marketplaces that connect diverse agents in social and economic activity. Platforms are most readily identified with their technical standards, i.e. engineering specifications for hardware and standards for software. The pricing and product strategies that platforms use differ from those of traditional firms because of the presence of network effects. Network effects are within platforms because participation by one group affects the utility of another group. Furthermore, network effects make the analysis of competition between platforms more complex than the analysis of competition between traditional firms. Much work in the economics of digitization studies the question of how these firms should operate and how they compete with each other. A particularly important issue is whether successful online platforms should be subject to anti-trust actions.

Digitization has partially or fully replaced many tasks that were previously done by human labourers. At the same time, computers have made some workers much more productive. Economists are interested in understanding how these two forces interact in

determining labour market outcomes. For example, a large literature studies the magnitude and causes of skill-biased technical change, the process by which technology improves wages for educated workers.

Another consequence of digitization is that it has drastically reduced the costs of communication between workers across different organizations and locations. This has led to a change in the geographic and contractual organization of production.

Privacy and data security is an area where digitization has substantially changed the costs and benefits to various economic actors. Traditional policies regarding privacy circumscribed the ability of government agencies to access individual data. However, the large-scale ability of firms to collect, parse, and analyze detailed micro-level data about consumers has shifted the policy focus. Now, the concern is whether access consumer data of firms should be regulated and restricted or not.

There are many other policies related to digitization that are of interest to economists. For example, digitization may affect government effectiveness and accountability. Digitization also makes it easier for firms in one jurisdiction to supply consumers in another. This creates challenges for tax enforcement. Many safety and quality enforcement regulations may no longer be necessary with the advent of online reputation systems. Lastly, digitization is of great importance to health care policy. For example, electronic medical records have the potential to make healthcare more effective but pose challenges to privacy policy.

## **1.2 Digital economy and knowledge economy**

### **1.2.1 Digital Economy**

It refers to an economy that is based on digital technologies. The digital economy is also sometimes called the internet economy, new economy, or web economy. Increasingly, the digital economy is intertwined with the traditional economy making a clear delineation harder.

In this new economy, digital networking and communication infrastructures provide a global platform over which people and organizations devise strategies, interact, communicate, collaborate and search for information.

It is widely accepted that the growth of the digital economy has widespread impact on the whole economy. Various attempts at categorising the size of the impact on traditional sectors have been made.

Given its expected broad impact, traditional firms are actively assessing how to respond to the changes brought about by the digital economy. For corporations, timing of

their response is of the essence. Banks are trying to innovate and use digital tools to improve their traditional business.

### **1.2.2 Knowledge economy**

Knowledge economy is the use of knowledge to generate tangible and intangible values. Technology and in particular knowledge technology help to transform a part of human knowledge to machines. This knowledge can be used by decision support systems in various fields and generate economic values. Knowledge economy is also possible without technology.

Other than the agricultural-intensive economies and labour-intensive economies, the global economy is in transition to a knowledge economy, as an extension of an information society in the information age led by innovation. The transition requires that the rules and practices that determined success in the industrial economy need rewriting in an interconnected, globalized economy where knowledge resources such as trade secrets and expertise are as critical as other economic resources.

A key concept of the knowledge economy is that knowledge and education (often referred to as human capital) can be treated as one of the following two:

- A business product, as educational and innovative intellectual products and services can be exported for a high value return.
- A productive asset.

It can be defined as products and services based on knowledge-intensive activities that contribute to an accelerated pace of technical and scientific advance, as well as rapid obsolescence. The key component of a knowledge economy is a greater reliance on intellectual capabilities than on physical inputs or natural resources.

The key problem in the formalization and modelling of knowledge economy is a vague definition of knowledge, which is a rather relative concept. For example, it is not proper to consider information society as interchangeable with knowledge society. Information is usually not equivalent to knowledge. Their use, as well, depends on individual and group preferences.

The knowledge economy is also seen as the latest stage of development in global economic restructuring. Thus far, the developed world has transitioned from an agricultural economy to industrial economy to post-industrial/mass production economy to knowledge economy. This latest stage has been marked by the upheavals in technological innovations and the globally competitive need for innovation with new products and processes that develop from the research community.

In the knowledge economy, the specialized labour force is characterized as computer literate and well-trained in handling data, developing algorithms and simulated

models, and innovating on processes and systems. Consequently, computer scientists, engineers, chemists, biologists, mathematicians, and scientific inventors will see continuous demand in years to come. Hence, knowledge is the catalyst and connective tissue in modern economies.

Knowledge provides the technical expertise, problem-solving, performance measurement and evaluation, and data management needed for the trans-boundary, interdisciplinary global scale of today's competition.

Worldwide examples of the knowledge economy taking place among many others include: Silicon Valley (California, US); aerospace and automotive engineering (Munich, Germany); biotechnology (Hyderabad, India); electronics and digital media (Seoul, South Korea); and petrochemical and energy industry in (Brazil).

It has been suggested that the next evolutionary step after knowledge economy is the network economy, where the relatively localized knowledge is now being shared among and across various networks for the benefit of the network members as a whole.

The knowledge economy has manifold forms in which it may appear but there are predictions that the new economy will extend radically, creating a pattern in which even ideas will be recognised and identified as a commodity. This certainly is not the best time to make any hasty judgment on this contention, but considering the very nature of knowledge itself, added to the fact that it is the thrust of this new form of economy, there certainly is a clear way forward for this notion, though the particulars remain in the speculative realm, as of now.

### **1.3 Income tax in India: Brief introduction**

Besides being the main source of direct tax revenue for the government, income tax is an effective instrument to realise various socio-economic objectives of national policies.

Taxation of income in India may be classified into two broad categories: (a) taxation of non-agricultural income, a Central subject, and (b) taxation of agricultural income, a matter for State legislation. The two relevant entries in List I (Union List) of the Seventh Schedule of the Constitution which empower the Parliament to levy income tax are: Entry 82, "taxes on income other than agricultural income", and Entry 85, "corporation tax". According to Article 366 (6) of the Constitution "corporation tax means any tax on income, so far as that tax is payable by companies".

For the purpose of taxation of non-agricultural incomes, the enactment is the Indian Income Tax Act, 1961 which is amended from time to time by the annual Finance Act and other legislations pertaining to direct taxes. Entities chargeable to tax under the Act are of two types: (i) non-corporate entities, and (ii) corporate entities. Non-corporate

entities mainly consist of individuals and firms and their taxation is called personal income tax. Income tax is the only notable source of direct tax revenue in India. Companies (corporations) and individuals are the two main taxpaying entities.

The States are empowered to make laws with respect to taxes on agricultural income vide entry 46 of List II (State List) of the Seventh Schedule of the Constitution. Therefore, agricultural income is exempt from Central income tax. However, from the assessment year 1974-75, agricultural income is taken into account to determine the rate of tax on non-agricultural income if agricultural income exceeds Rs. 5,000. Although the power to impose tax on agricultural income is vested in State Governments, in practice very few States have imposed this tax and wherever it is imposed the revenue is negligible.

Till recently, the proceeds from income tax were shareable with the States under Article 270 (1) of the Constitution. The Finance Commission recommended the formula for the distribution of income tax revenue between the Centre and the States and the distribution of States' share among the States themselves. Thus, income tax played an important role not only in Central finances but also in the finances of the State Governments.

The Constitution (Eightieth Amendment) Act, 2000 substituted a new Article for Article 270 under which States are now given a percentage share of all Central taxes and duties. However, the surcharge levied for purposes of the Union under Article 271 is excluded from the divisible pool.

The present law of income tax in India is governed by the Income Tax Act, 1961.

#### **1.4 Department of revenue**

The Department of Revenue functions under the overall direction and control of the Secretary (Revenue). It exercises control in respect of matters relating to all the direct and indirect union taxes through two statutory boards, namely the Central Board of Direct Taxes (CBDT) and the Central Board of Indirect Taxes and Customs (CBIC). Each board is headed by a chairman who is also ex-officio special secretary to the Government of India. Matters relating to the levy and collection of all direct taxes are looked after by the CBDT whereas those relating to levy and collection of indirect taxes and customs fall within the purview of the CBIC. The two boards were constituted under the Central Board of Revenue Act, 1963.

##### **1.4.1 Central board of direct taxes (CBDT)**

CBDT is part of the Department of Revenue in the Ministry of Finance. While the CBDT provides essential inputs for policy and planning of direct taxes in India, it is

also responsible for administration of direct tax laws through its Income Tax Department which is primarily responsible for combating the menace of black money. For this purpose, it uses the tools of scrutiny assessment as well as information-based investigations for detecting tax evasion and penalizing the same as per provisions of the Income Tax Act, 1961 with the objective of creating deterrence against tax evasion. In doing so, it plays one of the most important roles in preventing generation, accumulation, and consumption of unaccounted black money. Investigation Wing of the Income Tax Department deals with investigations to detect tax evasion and carries out operations like surveys and searches to collect evidence of such evasion. Such operations are usually carried out after detailed preliminary investigations and in cases involving substantial evasion of taxes.

Income Tax Department is also engaged in the task of educating and assisting taxpayers in filing tax returns, assessing tax liability, demanding pending taxes, penalising dishonest taxpayers and disposing of tax disputes. The role of this Department in tax system of India is rapidly increasing as the share of direct taxes in the revenue of the country has registered a steady increase over the years.

Permanent Account Number (PAN) issued by Income Tax Department is the critical element in capturing incomes and expenditures of a person. The Department identifies an assessee with PAN which is a unique 10 digit alpha-numeric number. Obtaining PAN is compulsory not only for income tax purposes but also for certain other transactions. PAN is to be obtained only once for ever. An assessee need not obtain a new PAN, even if he is transferred to any other place.

### **1.5 Honouring the honest platform**

Government has consistently adopted reform measures aimed at the long-term benefits of a more transparent, efficient and taxpayer-friendly tax administration. A major step in this direction is the introduction of Honouring the Honest Platform. The platform for Transparent Taxation—Honouring the Honest was launched in August 2020 with the objective to impart greater efficiency, transparency and accountability, and to eliminate physical interface between taxpayers and tax officers.

The key features of the platform are (a) usage of technology, data analytics and artificial intelligence and (b) recognizing taxpayers as partners in nation-building. The Platform stands on 3 pillars of tax administration reforms namely faceless assessment, faceless appeal, and taxpayers' charter. The platform is designed to ensure fairness by adopting measures like random selection through system using data analytics and artificial intelligence, dynamic jurisdiction, automated random allocation of cases, team-based assessment/review, provision of draft assessment order/review and finalization of

the order in different cities and no requirement of physical interface between taxpayers and the department.

### **1.6 Faceless Assessment Scheme 2020**

The Faceless Assessment Scheme, 2019 (earlier called the E-assessment Scheme) <sup>[1]</sup> was based on the idea that automated random allocation of cases across income tax teams with dynamic jurisdiction and elimination of face-to-face contact between the income-tax authorities and the taxpayer can lead to an efficient, non-discretionary, unbiased single window system of assessment. In 2020, the scope of Faceless Assessment Scheme 2019 was broadened by bringing all the pending assessment cases across the country within the purview of the scheme and declaring that any order passed outside the scheme shall be invalid. Faceless Assessment Scheme, 2020 abolished the earlier system of tax administration and assessment based on territorial jurisdiction. It provides for assessment by randomly chosen virtual teams with dynamic jurisdiction.

The scheme establishes a National Faceless Assessment Centre (NFAC) in Delhi, headed by Principal Chief Commissioner of Income Tax, as the sole point of contact between the department and the taxpayer. All notices or communications to and from the taxpayer, and internal communications related to assessment process within the department are routed through the NFAC. To further facilitate and streamline the process of assessment there are various Regional Faceless Assessment Centers which are vested with the power to make assessments.

### **1.7 Faceless appeals scheme 2020**

Under Faceless Appeals Scheme, 2020, all income tax appeals are finalised in a faceless manner under the faceless ecosystem with the exception of appeals relating to serious frauds, major tax evasion, sensitive and search matters, international tax and Black Money Act. The scheme establishes a National Faceless Appeal Centre (NFAPC) as the apex body for conduct of e-appeal proceedings in a centralized manner. Under the NFAPC are Regional Faceless Appeal Centers (RFAC) to facilitate the e-appeal proceedings. NFAPC is the only point of contact between the taxpayer and the underlying Appeal Units, and Appeal Units and NeAC/Assessing Officer. All internal and external communication takes place electronically and the assessee is not required to attend the proceedings personally or through an authorised representative.

### **1.8 Taxpayers' charter**

The third pillar of Honouring the Honest platform is the introduction of taxpayers' charter. The taxpayers' charter for India comprises of commitments by the



Income Tax Department and obligations of the taxpayers.

Traditionally, tax administrations paid limited attention to taxpayer service while performing the functions of regulator and enforcer of tax laws. However, due to an increased demand for better services to the tax payers, there has been a worldwide recognition of the rights of the tax payers, by publishing formal taxpayers' charters including behaviour expected from officials in the revenue department.

The introduction of taxpayers' charter by Government of India as a part of the Honouring the Honest platform is an important step in this direction, as it emphasizes the importance of fair, courteous and reasonable treatment of taxpayers. The taxpayers' charter includes the following as a part of Income Tax Department's commitment:

### **1.8.1 Taxpayers' rights**

As specified in the charter, these are as under:

- Courteous, fair and reasonable treatment to taxpayers.
- Treatment of taxpayers as honest unless the department has a reason to believe otherwise.
- Fair and impartial appeal procedure and review mechanism.
- Accurate and complete information for fulfilling tax compliance obligations under the law.
- Timely decisions in every income tax proceeding (within the time prescribed under law).
- Collection of the correct amount of tax due as per the law.
- Respect for privacy of the taxpayer by following due process of law, and ensuring no more intrusive than necessary in inquiry, examination, or enforcement action.
- Maintaining confidentiality by not disclosing any information provided by taxpayer to the department unless authorized by law.
- Ensuring accountability for the actions of the tax authorities.
- Provision to allow taxpayer to choose an authorized representative of his choice.
- Provision for a mechanism to lodge complaint and ensure its prompt disposal thereof.
- Fair and impartial system in resolving the tax issues in a time-bound manner
- Publishing the service standards and report periodically by the tax department.
- Reduced cost of compliance as the department shall duly take into account the cost of compliance when administering tax legislation.

### **1.8.2 Taxpayers' Obligations**

As specified in the charter, these are as under:

- Taxpayer is expected to honestly disclose full information and fulfil his compliance obligations.
- Taxpayer is expected to be aware of his compliance obligations under tax law and seek help of department if needed.
- Taxpayer is expected to keep accurate records required as per law.
- Taxpayer is expected to know what information and submissions are made by his authorized representative.
- Taxpayer is expected to make submissions as per tax law in a timely manner.
- Taxpayer is expected to pay amount due as per law in a timely manner.

### **1.8.3 E-filing of returns, e-payment of income tax and digital signature**

E-filing of income tax return is the process of electronically filing returns through internet which can be filed at any time at any place.

A new e-filing portal was launched in 2021 with improved features such as a new taxpayer-friendly portal integrated with immediate processing of income tax return (ITR), pre-filled returns, free of cost ITR preparation software, new call centre for taxpayer assistance including mobile app function.

This facility is provided to the taxpayers for making income tax payment through internet banking facility or through internet by using credit/debit cards. An assessee can make payment from his own account or from the account of any other person in an authorized bank. However, the challan must clearly indicate the permanent account number (PAN) of the assessee on whose behalf the payment is made.

A person desiring to furnish his return of income electronically, may sign it digitally or manually. For signing the return digitally, he is required to obtain a digital signature. A digital signature is the electronic signature issued by the certifying authority that shows the authenticity of the person signing the same.

### **1.9 Other simplification measures**

To ease burden of senior citizens above the age of 75 years, they have been given exemption from filing income tax returns if they only have pension income and interest income. In their case the specified bank is responsible for computing their income and deduction of tax.

Certain non-resident persons have also been exempted from the requirement of furnishing of income tax returns, subject to fulfilment of prescribed conditions. The

benefit of exemption is available from Assessment Year 2021-22 onwards. Relief has also been provided to NRIs regarding issues being faced on accrued incomes in their foreign retirement accounts.

To reduce the compliance on small charitable trusts running educational institutions and hospitals, relief by way of tax exemption to such trusts has been provided by the Finance Act 2021 by increasing the existing threshold of annual receipts from Rs. 1 crore to Rs. 5 crore. Certain improvements have also been introduced in the registration process for charitable trusts with the department including online process for filing of application, on-line processing of the applications and passing of the registration orders, online filing of donation statements by donee etc.

Faceless Penalty Scheme 2021 was launched to impart greater efficiency, transparency and accountability to the procedure for imposition of penalty. The scheme makes it possible for taxpayers to submit replies and participate in the proceedings at their convenience.

### **Endnote**

1. E-assessment Scheme: Finance Minister Arun Jaitley in his budget speech to the Parliament on February 1, 2018 announced, "We had introduced e-assessment in 2016 on a pilot basis and in 2017, extended it to 102 cities with the objective of reducing the interface between the department and the taxpayers. With the experience gained so far, we are now ready to roll out the e-assessment across the country, which will transform the age-old assessment procedure of the income tax department and the manner in which they interact with taxpayers and other stakeholders. Accordingly, I propose to amend the Income-tax Act to notify a new scheme for assessment where the assessment will be done in electronic mode which will almost eliminate person-to-person contact leading to greater efficiency and transparency." Government of India, Ministry of Finance, Budget Papers (2018-19), Speech of the Finance Minister, para 157.

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